

DEPARTMENT OF THE TREASURY

Departmental Offices

31 CFR Part 50

RIN 1505-AA96

Terrorism Risk Insurance Program

AGENCY: Departmental Offices, Treasury

ACTION: Final rule.

SUMMARY: The Department of the Treasury (Treasury) is issuing this rule in final form as part of its implementation of Title I of the Terrorism Risk Insurance Act of 2002 (Act). That Act established a temporary Terrorism Risk Insurance Program (Program) under which the Federal Government will share the risk of insured loss from certified acts of terrorism with commercial property and casualty insurers until the Program sunsets on December 31, 2005. Treasury published an interim final rule with a request for comment on February 28, 2003. That rule set forth the purpose and scope of the Program and key

definitions that Treasury will use in implementing the Program. It was the first in a series of regulations that Treasury will be issuing to implement the Program. This final rule generally adopts the interim final rule, but makes revisions in the definition of “affiliate” and certain other changes described in the preamble.

DATES: This final rule is effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER]

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SUPPLEMENTARY INFORMATION:

I. Background

A. Terrorism Risk Insurance Act of 2002

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002 (Public Law 107-297, 116 Stat. 2322). The Act was effective immediately. Title I of the Act establishes a temporary federal program of shared public and private compensation for insured commercial property and casualty losses resulting

from an act of terrorism as defined in the Act and certified by the Secretary of the Treasury, in concurrence with the Secretary of State and the Attorney General. The Act authorizes Treasury to administer and implement the Terrorism Risk Insurance Program, including the issuance of regulations and procedures. The Program will sunset on December 31, 2005.

The Act's purposes are to address market disruptions, ensure the continued widespread availability and affordability of commercial property and casualty insurance for terrorism risk and to allow for a transition period for the private markets to stabilize and build capacity while preserving State insurance regulation and consumer protections. The amount of Federal payment for an insured loss resulting from an act of terrorism is to be determined based upon the insurance company deductibles and excess loss sharing with the Federal Government, as specified by the Act. Thus, the Program provides a Federal reinsurance backstop for a temporary period of time. The Act also provides Treasury with authority to recoup Federal payments made under the Program through policyholder surcharges, up to a maximum annual limit.

Each entity that meets the definition of "insurer" (well over 2000 firms) must participate in the Program. From the date of enactment of the Act through the last day of Program Year 2 (December 31, 2004), insurers under the Program must "make available" terrorism risk insurance in their commercial property and casualty insurance policies and the coverage must not differ materially from the terms, amounts and other coverage limitations applicable to commercial property and casualty losses arising from events

other than acts of terrorism. The Act permits Treasury to extend the “make available” requirement into Program Year 3, based on an analysis of factors referenced in the study required by section 108(d)(1) of the Act, and not later than September 1, 2004.

An insurer’s deductible increases each year of the Program, thereby reducing the Federal government’s involvement prior to sunset of the Program. An insurer’s deductible is based on “direct earned premiums” over a statutory Transition Period and the three Program Years. Once an insurer has met its deductible, the Federal payments cover 90 percent of insured losses above the deductible, subject to an aggregate annual cap of \$100 billion. The Act prohibits duplicative payments for insured losses that have been covered under any other Federal program.

As conditions for federal payment under the Program, insurers must provide clear and conspicuous disclosure to the policyholders of the premium charged for insured losses covered by the Program, and must submit a claim and certain certifications to Treasury. Treasury will be prescribing claims procedures at a later date.

The Act also contains specific provisions designed to manage litigation arising from or relating to a certified act of terrorism. Section 107 creates an exclusive federal cause of action, provides for claims consolidation in federal court and contains a prohibition on Federal payments for punitive damages under the Program. This section also provides the United States with the right of subrogation with respect to any payment or claim paid by the United States under the Program.

B. The Interim Final Rule

The interim final rule established Subpart A of a new Part 50 in Title 31 of the Code of Federal Regulations. Subpart A of new Part 50 contains certain general provisions and definitions of Program terms. The definitions contained in the interim final rule provide the foundation for participation by insurers under the Federal reinsurance Program created by the Act.

Some of the definitions in the interim final rule were taken virtually verbatim from the Act because they do not need further clarification. For other definitions, the interim final rule generally incorporated previously issued interim guidance provided by Treasury as it pertains to Program terms, for example, the terms “insurer,” “affiliate,” “property and casualty insurance” and “direct earned premium.” Such interim guidance was published at 67 FR 76206 (December 11, 2002), 67 FR 78864 (December 26, 2002) and 68 FR 4544 (January 29, 2003). In several areas, the interim final rule made clarifying modifications to, or supplemented, the previously issued interim guidance.

In implementing the Program, Treasury has been guided by several goals. First, we strive to implement the Act in a transparent and effective manner that treats comparably those insurers required to participate in the Program and that provides necessary information to policyholders in a useful and efficient manner. Second, Treasury seeks to rely as much as possible on the State insurance regulatory structure. In that regard, Treasury is closely coordinating with the National Association of Insurance

Commissioners (NAIC) in implementing definitional and other aspects of the Program. Third, to the extent possible within statutory constraints, Treasury seeks to allow insurers to participate in the Program in a manner consistent with their normal course of business. Finally, given the temporary and transitional nature of the Program, Treasury is guided by the Act's goal for insurers to develop their own capacity, resources and mechanisms for terrorism risk insurance coverage when the Program expires.

II. Summary of Comments and Final Rule

Treasury received over 40 comments on the interim final rule. Comments were submitted by insurance companies, industry trade associations, the NAIC, two cities, and by two members of Congress. After review and careful consideration of these comments, as well as additional research and consultation with the NAIC, Treasury is now promulgating a final rule concerning TRIA definitions. In general, the final rule reflects the interim final rule. However, revisions and clarifications were made in several areas, based on comments received. For example, revisions were made to the rebuttable presumptions to controlling influence determinations under the definition of "affiliate," and clarifications were made to the definitions of "direct earned premium" and "commercial property and casualty insurance." The final rule, including changes and clarifications, is discussed in the summary below.

A. "Act of Terrorism" (Section 50.5.b)

The interim final rule incorporated the statutory definition of “act of terrorism” found in section 102(1) of the Act. In that regard, the interim final rule provides that an “act of terrorism” for purposes of the Program must be certified by the Treasury Secretary, in concurrence with the Secretary of State and the Attorney General of the United States, and must fall within other statutory parameters. The requirements in clauses (i) – (iv) of section 102(1)(A) are conjunctive. An act of terrorism, if it also meets the limitations in section 102(1)(B), may be certified if it: is violent or dangerous to human life, property or infrastructure; and has resulted in damage within the United States, or outside the United States in the case of certain air carriers or vessels or if on the premises of a U.S. mission; and has been committed by individual(s) on behalf of any foreign person or foreign interest, as part of an effort to coerce the U.S. civilian population or to influence the policy or affect the conduct of the U.S. government by coercion. Therefore, acts of domestic civil disturbance would not be covered by the Act’s definition of “act of terrorism” or by the Program.

Section 102(1)(B) limits the Secretary’s ability to certify an act if committed as part of a course of war declared by Congress, (except for workers’ compensation coverage), or if property and casualty insurance losses resulting from the act, in the aggregate, do not exceed a \$5,000,000 de minimis threshold. With regard to the first limitation, one commenter raised a question concerning the effect of a declaration of war on an act of terrorism certification. While it is not possible for a regulation to address all potential situations surrounding an act of terrorism determination under the Program, it is Treasury’s view that the war exclusion in the Act applies only to acts of terrorism

committed in connection with a formal, congressionally declared war. While the phrase “war declared by the Congress” is not defined in the Act, Article I, section 8, clause 11 of the Constitution grants Congress the exclusive authority to declare war. Congress has done so on five occasions, the most recent of which occurred in 1941 at the outset of World War II. Most other American military actions have been conducted pursuant to constitutional authorities of the President connected with his role as commander-in-chief, and while many of these have also enjoyed explicit Congressional support, they have not been authorized by a formal declaration of war. For example, the “Authorization for Use of Military Force Against Iraq Resolution of 2002,” (P.L. 107-243) gave the President authority to conduct military operations, but is not a formal declaration of war.

With regard to the second statutory limitation on an act of terrorism certification, one commenter asked whether the \$5,000,000 threshold loss has to be suffered by one insured policyholder. The Act, as reflected in the interim final rule, provides that the *de minimis* threshold is based on loss “in the aggregate”. One certified act of terrorism could result in insured losses from several policyholders, none of which alone would amount to \$5,000,000, but, in the aggregate, would be in excess of that amount.

Section 106(a)(2) of the Act provides that the Act’s definition is the exclusive definition of the term “act of terrorism” for purposes of compensation for insured losses under the Act. In addition, section 102(1)(C) of the Act provides that the Secretary’s determination or certification with regard to whether an act is an act of terrorism for purposes of the Program is final and is not subject to judicial review.

One commenter urged Treasury to establish a time frame within which the Secretary would be required to make a determination or certification that an “act of terrorism” had occurred in order to better assist insurers in responding to inquiries and claims from their policyholders. Treasury understands the desire for certainty of those in the industry who would advocate a definite time frame, and intends to make its determination as promptly as possible after obtaining and evaluating the facts surrounding a possible act of terrorism. However, there is no way to predict future events and ascertain a time frame that would be appropriate for all potential situations. Facts could be immediately available and, after consultation, present a clear basis for a quick determination by the Secretary; conversely, a determination could require more time to gather information and conduct an analysis of the act. Given this inherent uncertainty and the significance of an act of terrorism determination to all aspects of the Program, Treasury does not believe that it would be in the public interest to establish in advance a regulatory time frame that may later prove to be inappropriate or unattainable.

B. “Affiliate” including “Control” (Section 50.5(c))

Approximately one-third of the comments submitted to Treasury on the interim final rule raised questions or concerns with regard to the definition of “affiliate”, which includes the definition of “control” in section 50.5(c). Most of these comments raised questions with either procedural or substantive aspects of the rebuttable presumptions of controlling influence in this section. After careful consideration of the comments and

further consultation with the NAIC, Treasury has made several revisions in the final rule to address these comments. The regulatory definitions and changes to the interim final rule are set forth below.

Section 102(6) of the Act defines an “insurer” to include “any affiliate thereof.” The definitions of “affiliate” and “control” are intertwined in the Act. Section 102(2) defines “affiliate” to mean “with respect to any insurer, an entity that controls, is controlled by, or is under common control with the insurer.” Pursuant to Section 102(3) of the Act, “control” exists if

- an entity directly or indirectly or acting through 1 or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other entity; or
- an entity controls in any manner the election of a majority of the directors or trustees of the other entity; or
- the Secretary determines, after notice and opportunity for hearing, that the entity directly or indirectly exercises a controlling influence over the management or policies of the other entity.

Section 50.5(c) of the interim final rule generally incorporates and combines the related statutory definitions of “affiliate” and “control.” In addition, the interim final rule provides that an affiliate must itself meet the definition of “insurer” to participate in the Program. (See part E of this preamble for further discussion of “insurer” definition.)

The definitions of affiliate and control are integral to Treasury's implementation of the Program. As discussed further in parts C and F of this preamble, affiliated insurers are treated collectively as one entity by Treasury for purposes of calculating direct earned premiums and an insurer deductible under the Program. Three comments objected to this consolidated treatment as not equitable. However, as noted in the preamble to the interim final rule, this consolidated treatment is in accord with the Act's legislative history and the clear intent of Congress. The Conference Report states that the terms "affiliate" and "control" were meant "to ensure that affiliated insurers are treated as a consolidated entity for calculating direct earned premiums." H.R. Conf. Rep. No. 107-779 (2002).

Therefore, for example, if an insurance company meets the definition of an "insurer" under section 102(6) as implemented by Treasury, and three out of four of the companies it controls also meet the Act's definition of "insurer," then the parent company and the three companies it controls that meet the Act's definition of "insurer" (the parent company's affiliates) will be treated by Treasury collectively as one insurer for purposes of calculating direct earned premiums and calculating the insurer deductible under the Program. The company that does not meet the definition of "insurer" is not included in the Program.

In addition, if an entity is under common control with an insurer, and that entity also meets the definition of "insurer" under Section 102(6) of the Act as implemented by Treasury, then the two insurers are "affiliates" and Treasury will treat them collectively as one "insurer" for the Program purposes of consolidating direct earned premiums and

calculating the insurer deductible. If their parent company does not meet the definition of “insurer” under the Act, then it is not included in the Program.

Control

The statutory definition of “control” in section 102(3) contains three categories. Section 102(3)(A) and (B) establish conclusive control under certain circumstances for purposes of the Program. The conclusive control provisions of the Act are contained in the definition of “affiliate” in the interim final rule at section 50.5(c)(2)(i) and (ii). If a relationship between or among insurers does not fit within the conclusive control provisions, control may still exist for purposes of the Program if Treasury determines, pursuant to section 102(3)(C), that an entity directly or indirectly exercises a controlling influence over the management or policies of another entity. Section 102(3)(C) is contained in the interim final rule at section 50.5(c)(2)(iii). In making a determination of whether controlling influence exists among insurers, section 102(3)(C) of the Act requires Treasury to provide notice and an opportunity for a hearing.

The Act’s definition of control in section 102(3)(A), (B) and (C) is almost identical to the definition of “control” contained in the Bank Holding Company Act (BHCA) at 12 U.S.C. 1841(a)(2) and in the Savings and Loan Holding Company Act (SLHCA) at 12 U.S.C. 1467a, except that the Act does not contain a presumption of no control for holding less than 5 percent of any class of voting securities, nor does the Act provide any of the other explicit statutory exemptions that are provided in the BHCA and SLHCA. The Act’s definition of control is also similar to the definition of control in the

NAIC's Model Insurance Company Holding Company Act (Model Act) except that the Model Act contains a presumption of control if an entity owns 10 percent of the voting securities of an insurance company instead of the 25 percent conclusive control threshold that is contained in the Act (and in the BHCA and the SLHCA).

Owns, Controls or has the Power to Vote 25 Percent or More of Voting Securities

Under Section 102(3)(A) of the Act, “an entity has ‘control’ over another entity if the entity directly or indirectly or acting through 1 or more persons owns, controls or has the power to vote 25 percent or more of any class of voting securities of the other entity.” The interim final rule incorporates this statutory definition, but uses the word “insurer” instead of “entity” to clarify that the definition of control does not include entities that are not insurers.

One commenter asked for clarification that an affiliate itself must be an insurer to be treated as part of a consolidated entity with a related insurer. In view of the congressional intent that affiliated insurers be treated as a consolidated entity for purposes of calculating direct earned premiums, there is no reason to include non-insurer entities in the definition of “affiliate” because these entities do not have “direct earned premiums” as defined in the Act. Viewing a group of affiliates with both insurer and non-insurer entities, the direct earned premiums for the group should be no different whether or not the non-insurers are included in the group. For this reason, Treasury has decided to interpret the Act as generally excluding non-insurers from the definitions of

affiliate and control at this time. Treasury could revisit this issue if it finds evidence that other corporate structures or arrangements are being used to thwart the goals and purposes of the Program.

Five insurance industry commenters took the position that ownership of 25 percent or more of the voting securities of an insurer should not automatically result in control. These commenters asserted that Treasury could and should by regulation change this statutory limit. One commenter referenced the NAIC Model Act language in support of creating a regulatory presumption. As noted above, unlike section 102(3)(A), the NAIC Model Act contains a 10 percent statutory presumption not a threshold of conclusive control. Several of these commenters stated that a 25 percent or more conclusive control limit could adversely affect the availability and affordability of coverage, and in particular, would have an adverse effect on their own companies if they were required to aggregate direct earned premiums. These commenters suggested various alternatives for Treasury to use instead of the 25 percent statutory limit. These included substituting other regulatory factors for the 25 percent limit and accepting a state determinations of “no control” based on state law even where there is ownership of more than 25 percent.

Consistent with the statutory language in section 102(3)(A) and with other statutes containing similar language, Treasury interprets the 25 percent or more direct or indirect ownership of any class of voting securities to be an objective standard establishing conclusive control. Under the plain language of the statute, the 25 percent

voting securities threshold is not a presumption, and is not subject to rebuttal. We also note that in addressing the rebuttable presumptions in the interim final rule in connection with section 102(3)(C), several commenters characterized the ownership of 25 percent or more of any class of voting securities threshold in section 102(3)(A), as well as the control provision in section 102(3)(B), as objective standards. For these reasons, Treasury has not made any change in the final rule to the 25 percent threshold in section 50.5(c)(2)(ii) of the interim final rule.

Controls the Election of a Majority of the Directors or Trustees

The interim final rule provides that an insurer controls another insurer for purposes of the Program if the insurer controls in any manner the election of a majority of the directors or trustees of the other insurer. In general, this regulatory provision incorporates the statutory language in section 102(3)(B). For the reasons stated above in connection with section 102(3)(A), Treasury interprets the section 102(3)(B) as another objective standard that establishes conclusive control for purposes of the Act. This standard is not a presumption and is not subject to rebuttal.

Controlling Influence and Rebuttable Presumptions

In addition to the conclusive control provisions in section 102(3)(A) and (B), the Act defines control to exist if, “the Secretary determines, after notice and opportunity for hearing, that the entity directly or indirectly exercises a controlling influence over the

management or policies of the other entity.” Section 102(3)(C). In the interim final rule, Treasury established several rebuttable presumptions for the purposes of a determination of controlling influence: (1) if a State has determined that an insurer controls another insurer; (2) if an insurer provides 25 percent or more of another insurer’s capital (in the case of a stock insurer), policyholder surplus (in the case of a mutual insurer), or corporate capital (in the case of other entities that qualify as insurers); or (3) if an insurer, at any time during a Program Year, supplies 25 percent or more of the underwriting capacity for that year to an insurer that is a syndicate consisting of a group including incorporated and individual unincorporated underwriters.

Section 50.5(c)(4) of the interim final rule provided an insurer with an opportunity for an informal hearing to rebut a controlling influence presumption through written submissions and, in addition in Treasury’s discretion, by an informal oral presentation. Treasury subsequently issued a notice on March 25, 2003 (68 FR 15039, March 27, 2003, “Interim Guidance IV”) providing further guidance on the procedure for rebutting a presumption of controlling influence.

In establishing several rebuttable presumptions in Section 50.5(c)(3) of the interim final rule, Treasury had two key goals. One was to provide additional transparency about the factors that Treasury considers indicative of controlling influence to provide greater certainty to insurers prior to a final determination of control and thereby facilitate the calculation of insurer deductibles prior to presentment of a claim.

The second was to enhance administrative efficiency given available time and other resources in this temporary Program.

With regard to the second goal, we point out that, in the Act, Congress established a temporary backstop program with the expectation that Treasury would not build a large bureaucratic program structure, but instead would leverage off of the state insurance regulatory structure, where possible and appropriate. Unlike state insurance commissioners, or state or federal bank examiners, Treasury does not conduct regular on-site examinations of Program participants, nor does it routinely review acquisitions, mergers or other transactions of such insurers. Thus, Treasury does not have ready access to detailed information on the control relationships of insurers that is generally available to regulators that implement the control provisions of the BHCA, the SLHCA, or state insurance law.

At this point, it is unclear to Treasury how many insurers fall outside section 102(3)(A) and (B) but may come within the controlling influence category. Rejecting the imposition of significant new regulatory reporting requirements on the property and casualty insurance industry, Treasury decided to utilize regulatory presumptions to accomplish these two goals and to implement the controlling influence provisions.

Treasury received 6 comments, from insurers and from a large insurance industry trade group, taking exception to the rebuttable presumptions as presented in the interim

final rule. These commenters objected on procedural and substantive grounds. In addition, one commenter supported, in principle, the rebuttable presumption process.

Most of these commenters objected to the reliance on a state law determination of control in the first rebuttable presumption in the interim final rule. They contended that exclusive reliance on a state law determination, for purposes of a rebuttable presumption, was inappropriate given the varying state standards and the differences between the Act's definition of "control", and the definition of "control" in the NAIC Model Law used by most states. Several commenters suggested that Treasury utilize specific guidelines or standards (such as the existence of a management agreement) instead of rebuttable presumptions.

After consideration of these comments and the stated administrative goals, Treasury has decided to retain the use of rebuttable presumptions, with modifications. Use of the rebuttable presumptions provides increased certainty and transparency to insurers and others of the factors that Treasury considers indicative of a controlling influence. Rebuttable presumptions have been and are used successfully by other agencies in implementing nearly identical statutory definitions of "control." Rebuttable presumptions also aid efficient implementation of the controlling influence determination process, given that Treasury does not have ready access to relevant information about the financial, managerial, policymaking and corporate structures of insurers. Moreover, a rebuttable presumption is not a final determination of controlling influence by Treasury. Under the final rule, insurers subject to rebuttable presumptions, and others that do not

fall within the conclusive control provisions and wish to have a final determination of controlling influence, all have an opportunity for a hearing. Based upon the comments, and further consultation with NAIC, Treasury is revising the rebuttable presumptions to provide more detail and transparency concerning factors that Treasury will consider indicative of controlling influence and is using these factors in the rebuttable presumptions. For example, in response to several comments, no rebuttable presumption relies exclusively on a state law determination of control in the absence of the existence of at least one of the listed control factors. The final rule also adds the existence of at least one of the control factors to the other two presumptions (which are based on the provision of 25 percent corporate capital/ policyholder surplus, or the provision of 25 percent underwriting capacity to another insurer).

In the final rule, if an insurer does not come within the conclusive control provisions of section 102(3)(A) or (B) (section 50.5 (c)(2)(i) or (ii) of the final rule), but at least *two* of the following control factors exists, then Treasury will presume controlling influence exists prior to a final determination unless and until rebutted by the insurer:

- The insurer is one of the two largest shareholders of any class of voting stock;
- The insurer holds more than 35 percent of the combined debt securities and equity of the other insurer;
- The insurer is party to an agreement pursuant to which the insurer possesses a material economic stake in another insurer resulting from a profit-sharing

- arrangement, use of common names, facilities or personnel, or the provision of essential services to another insurer;
- The insurer is party to an agreement that enables the insurer to influence a material aspect of the management or policies of another insurer;
 - The insurer would have the ability, other than through the holding of revocable proxies, to direct the votes of more than 25 percent of the other insurer's voting stock in the future upon the occurrence of an event;
 - The insurer has the power to direct the disposition of more than 25 percent of a class of voting stock in a manner other than a widely dispersed or public offering;
 - The insurer and/or the insurer's representative or nominee constitute more than one member of the other insurer's board of directors;
 - The insurer or its nominee or an officer of the insurer serves as the chairman of the board, chairman of the executive committee, chief executive officer, chief operating officer, chief financial officer or in any position with similar policymaking authority in another insurer;

In addition, if a State has determined that an insurer controls another insurer, *and* at least *one* of the factors listed above exists, then Treasury will presume controlling influence exists unless and until rebutted by the insurer.

Further, if an insurer provides 25 percent or more of another insurer's capital in the case of a stock insurer, policyholder surplus (in the case of a mutual insurer) or

corporate capital (in the case of other entities that qualify as insurers), *and* at least one of the factors listed above exists, then Treasury will presume a controlling influence exists unless and until rebutted by the insurer.

Finally, if an insurer, at anytime during the Program Year, supplies 25 percent or more of the underwriting capacity for that year to an insurer that is a syndicate consisting of a group including incorporated and individual unincorporated underwriters, *and* at least one of the factors in the above list exists, then Treasury will presume a controlling influence unless and until rebutted by the insurer.

A few of the commenters objected to the second and third rebuttable presumptions in the interim final rule as inconsistent with the conclusive control provisions in section 102(3)(A) and (B). As a general matter, Treasury is directed by the Act to treat insurers comparably under the Program. Treasury views the provision by an insurer of 25 percent of an insurer's corporate capital (or policyholder surplus), or supplying of 25 percent of an insurer's underwriting capacity for the Program Year, to indicate the functional equivalent of ownership of 25 percent of voting securities. As the administrator of the Program, Treasury also seeks to prevent loopholes in the regulations and elsewhere that may create opportunities to avoid or greatly minimize an insurer deductible merely on the basis of an insurer's unusual corporate structure or arrangement where, in effect, the insurer exercises a controlling influence over another insurer in the same or similar manner as the more traditional corporate structures of other insurers. The controlling influence determination authority in section 102(3)(C) aids Treasury's efforts

to treat insurers comparably and helps preserve the goals and effectiveness of the Program. As described below, the final rule provides insurers with an opportunity for a hearing and a final determination on controlling influence.

Opportunity for Hearing

Section 102(3)(C) of the Act authorizes Treasury to make a determination that an insurer directly or indirectly exercises a controlling influence over the management or policies of another insurer, after notice and opportunity for hearing. The statutory language providing an opportunity for hearing does not require a formal hearing on the record. In the interim final rule, Treasury provided an opportunity for an informal hearing to any insurer that 1) does not come within the conclusive control provisions of section 102(3)(A) or (B) and 2) wanted to rebut a presumption of controlling influence. The informal hearing procedure requires an insurer to provide Treasury with relevant facts and circumstances concerning the relationship and in support of the insurer's contention that no controlling influence exists. The procedure also allows a supplementary oral presentation by the insurer, if deemed necessary by Treasury. Based on the information provided by the insurer, including any oral presentation, the factors listed in the regulation and other relevant facts and circumstances, Treasury would then make a final determination of whether a controlling influence exists.

A few commenters contended that Section 554 of the Administrative Procedure Act ("APA"), 5 U.S.C. § 554, requires Treasury to hold a formal hearing for insurers

challenging determinations of entity control under section 102(3) of the Act. We do not agree. The APA's formal hearing requirements apply when a hearing on the record is required by statute. "While the exact phrase 'on the record' is not an absolute prerequisite to the application of formal hearing procedures, the Supreme Court has made clear that these provisions do not apply, unless Congress has clearly indicated that the 'hearing' required by the statute must be trial-type hearing on the record." *U.S. Lines Inc. v. Federal Maritime Commission*, 584 F. 2d 519 (D.C. Cir 1978) (citing *United State v. Florida East Coast R. Co.*, 410 U.S. 224, 234-38 (1973)). The D.C. Circuit added that, in that case, the statute did not provide for a hearing "on the record," and nothing in the terms of the statute or in its legislative history indicated that a trial-type hearing was intended. *Id.* Similarly, section 102(3)(C) of the Act does not require a hearing on the record and nothing in the language or history of the Act indicates that Congress intended Treasury to establish procedures and apparatus for formal trial-type hearings on the issue of controlling influence for purposes of this temporary Program.

In response to the comments received, the final rule revises the interim final rule to provide greater transparency in the controlling influence determination process. The final rule includes regulatory notice of specific factors that Treasury considers indicative of a controlling influence, and the rebuttable presumptions in the interim final rule are revised to avoid reliance on state law determinations without other indicia of control. The final rule affords insurers an opportunity to request an informal hearing in which an insurer may submit all relevant information on the issue of controlling influence, whether to rebut a presumption or to otherwise obtain a final controlling influence determination

from Treasury. As in the interim final rule, the final rule allows an oral presentation, where deemed necessary by Treasury to supplement the written submission. Treasury will base its final determination on the factors set forth in the final rule, on information provided to Treasury by the insurer and on other relevant facts and circumstances.

Although the final rule sets no deadline for an insurer to request a hearing, Treasury encourages insurers that do not come within the conclusive control provisions but that are in a relationship or arrangement in which the control factors apply or exist to request a hearing as soon as possible if they wish to rebut the regulatory presumptions of controlling influence and obtain a final determination from Treasury of whether the relationship involves a controlling influence (and therefore control).

Separately from the issuance of the interim final rule, Treasury solicited comment on a pro rata allocation method for control determinations under section 102(3)(C) of the Act, in situations in which multiple insurers each provide 25 percent or more of the capital of a stock insurer, policyholder surplus of a mutual insurer or corporate capital of other entities that meet the definition of insurer under the Act and in the interim final rule. The pro rata approach under consideration by Treasury would allocate premium on a pro rata basis in situations where there are multiple 25 percent owners. This approach is still under consideration by Treasury and may be proposed in connection with claims procedures.

Treasury anticipates proposing within claims procedures at a later date that the controlling insurer will be the insurer that will be required to file any claim with Treasury

for Federal payment under the Program and that this insurer will receive the Federal payment that is to be distributed within the consolidated insurer group in accordance with distribution of risk within the consolidated insurer group.

Treasury also solicited comment on various means to ensure the prompt distribution of the federal payment as appropriate to ensure that the purposes of the Program are not thwarted or evaded, and that the ultimate risk bearing entities are treated in an equitable manner, within the Act's requirements. Treasury will propose means of distribution of the federal payment in connection with the claims procedures at a later date.

C. Direct Earned Premium (Section 50.5.d) and Property and Casualty Insurance (Section 50.5.l)

The Act requires that “commercial property and casualty insurance” that falls within the scope of “insured loss” and that is written by an “insurer,” is part of the Program, and thus eligible for Federal payments and also subject to other provisions of the Act. Losses arising from a certified act of terrorism that do not meet these requirements are not eligible for Federal payments under the Program. For those losses that are eligible, the amount of Federal payment that an insurer may receive is subject to the insurer’s “insurer deductible,” which is determined by a calculation based on the insurer’s “direct earned premium”.

In the interim final rule, Treasury initially looked to the Act’s definition to ascertain the scope of commercial property and casualty insurance for purposes of the Program. Section 102(12) of the Act expressly *includes* several lines of insurance: excess insurance, workers’ compensation insurance and surety insurance. It also expressly *excludes* several additional lines of insurance: (i) Federal crop insurance issued or reinsured under the Federal Crop Insurance Act or any other type of crop or livestock insurance that is privately issued or reinsured; (ii) private mortgage insurance as defined in the Homeowners Protection Act or title insurance; (iii) financial guaranty insurance issued by monoline financial guaranty insurance corporations; (iv) insurance for medical malpractice; (v) health or life insurance including group life insurance; (vi) flood insurance provided under the National Flood Insurance Act of 1968; and (vii) reinsurance or retrocessional reinsurance.

In addition to these specific statutory inclusions and exclusions, Treasury needed to develop a uniform regulatory definition of commercial property and casualty insurance for purposes of the Program. Insurance is generally regulated by State law in the United States. After consulting with the NAIC and others, Treasury found no uniform or consistent definition of “commercial property and casualty insurance” among the States that could provide guidance or be used for purposes of the Program. In some States, a line of insurance may be considered as commercial; and, in other States, the same line of insurance may be considered as a personal line.

The closest reference point that Treasury found for a uniform definition was the NAIC’s Annual Statement’s Exhibit of Premiums and Losses (“Statutory Page 14”). Therefore, the interim final rule incorporated the interim guidance issued at 67 FR 76206 that designated those commercial lines reported on specified lines of Statutory Page 14 as commercial property and casualty lines of coverage to be included in the Program (subject to the Act’s specific inclusions and exclusions). The lines so specified were: Line 1 (Fire); Line 2.1 (Allied Lines); Line 3 (Farmowners Multiple Peril); Line 5.1 (Commercial Multiple Peril – non-liability portion); Line 5.2 (Commercial Multiple Peril – liability portion); Line 8 (Ocean Marine); Line 9 (Inland Marine); Line 16 (Workers’ Compensation); Line 17 (Other Liability); Line 18 (Products Liability); Line 19.3 (Commercial Auto No Fault – personal injury protection); Line 19.4 (Other Commercial Auto Liability); Line 21.2 (Commercial Auto Physical Damage); Line 22 (Aircraft – all perils); Line 24 (Surety); Line 26 (Burglary and Theft); and Line 27 (Boiler and Machinery). In making this determination Treasury considered the Act’s definition of “commercial property and casualty insurance” and how it relates to the lines of coverage listed on Statutory Page 14, the Program structure, and what would be necessary to effectively administer the Program. In developing the interim final rule, Treasury consulted with the NAIC and others regarding State law and premium reports filed with insurance regulators in the respective States and with the NAIC.

Section 102(4) of the Act defines “direct earned premium” to mean direct earned premium (DEP) for property and casualty insurance issued by any “insurer” for losses within the scope of “insured loss.” The interim final rule also clarified that premium

information on the specified lines of Statutory Page 14 should be included in calculating an insurer's DEP only *to the extent that coverage under the Program is provided for commercial property and casualty exposures*. Therefore, policies (or portions of policies) not eligible for Federal payments under the Program, such as personal lines or other lines of coverage (such as medical malpractice) specifically excluded by the Act, should not go into the calculation of an insurer's DEP. Treasury's approach is designed to maintain a close correlation between the lines of commercial property and casualty insurance eligible for the Federal payments under the Program, and the amount of premiums for those coverages that actually go into calculating an insurer's DEP under the Program.

Many policies have combined risk coverage (hybrid policies). Under some hybrid policies, some of the risks or lines are covered by the definition of commercial property and casualty insurance under the Program and some are not covered. To address these situations, the interim final rule allows (but does not require) an insurer to allocate a portion of the premium (*i.e.* that portion for covered lines or risks) in calculating an insurer's DEP under the Program. If an insurer does not choose to allocate its hybrid policy premiums in this manner, then the entire DEP reported on the specific lines of Statutory Page 14 must go into its DEP calculation, and also, potentially, into the recoupment base for that insurer. Treasury has not yet issued rules or procedures governing any potential recoupment under section 103(e)(7) of the Act or concerning the surcharges required by section 103(e)(8) of the Act. However, it is Treasury's expectation that an insurer's policies (or portions of policies) that go into calculating an

insurer's DEP would be the same policies (or portions of policies) that go into determining an insurer's recoupment base.

Instead of issuing a new reporting requirement or mandating a specific allocation formula for hybrid policies, Treasury has suggested several methods that insurers may use in adjusting and calculating their DEP under the Program:

(1) For policies with predominant personal line coverages, but where the premiums might also cover a portion for coverage of commercial risks, Treasury indicated that a policy would be considered personal, and not included in DEP, if the commercial portion was incidental (less than 25 percent of the total premium). If the commercial coverage portion represented more than 25 percent of the total premium, then the company should allocate the appropriate portion of the premium as commercial to be included in DEP.

(2) For policies written by insurers required to participate in the Program, but for which the premiums are not reported on Statutory Page 14 (e.g. certain county or town mutuals), the interim final rule suggested other methods by which adjustments could be made by the insurer to calculate its DEP. Specific methods were suggested in the interim final rule for county or town mutual insurers, eligible surplus line insurers, and federally approved insurers.

Included Versus Excluded Lines of Coverage in General

Several commenters were uncertain about whether the interim final rule's list of commercial lines as reported on the specified lines of Statutory Page 14 was exclusive or merely illustrative. Their uncertainty appears to arise from use of the word "includes" in section 50.5(l) of the interim final rule that property and casualty insurance ("includes commercial lines within the following lines of insurance.") These commenters suggested that Treasury clarify whether it intended for the list to be exclusive, or identify those lines of business that are excluded.

As previously noted, Treasury consulted with the NAIC and others concerning the definition of commercial property and casualty insurance. Finding no uniform or consistent definition of the term, Treasury determined that the NAIC's Statutory Page 14, provided the best available point of reference - not only for identifying the lines of coverage for the Program, but also for guidance in determining an insurer's DEP for those lines of coverage. Treasury intended that the list of specified lines on Statutory Page 14 would be exclusive, and premiums reported on other lines would not be part of the Program. The final rule revises the previous language to clarify this.

In its comment on the interim final rule, the NAIC suggested Treasury should add the following language from the Act: "...or any other type of crop or livestock insurance that is privately issued or reinsured" to section 50.5(l)(2)(i) of the interim final rule. The NAIC commented that such an addition would prevent any uncertainty concerning the treatment of crop or livestock coverage that is not part of the Program.

In developing the interim final rule, Treasury understood based on available information that privately issued or reinsured crop or livestock insurance was reported under Multiple Peril Crop insurance on Line 2.2 of Statutory Page 14. It is now Treasury's understanding, based on additional information from the NAIC, that privately issued or reinsured crop or livestock insurance is generally reported as Allied Lines insurance on Line 2.1 of Statutory Page 14. Therefore, in the final rule, Treasury has added the specific statutory language and the appropriate reporting lines of Statutory Page 14 to section 50.5(l)(2)(i) of the final rule.

The Act and interim final rule exclude Federal flood insurance which is a line of single peril natural disaster insurance. Similarly, the interim final rule excluded earthquake insurance reported on Statutory Page 14. Treasury received no comments on the interim final rule regarding the treatment of any single peril natural disaster insurance. However, in light of information subsequently received in response to Treasury's proposed rule concerning state residual market insurance entities, Treasury is considering issuing a proposed rule specifically requesting comment on the inclusion or exclusion in the Program definition of commercial property and casualty insurance of other single peril natural disaster insurance, such as stand alone, single peril wind insurance, if reported on included lines of Statutory Page 14.

Personal Lines

One commenter asserted that Treasury's determination that commercial coverage is incidental if its applicable premium is less than 25 percent of a hybrid personal/commercial lines policy premium would have adverse effects, suggesting that this could cause insurers to force incidental coverages off such personal policies, such as Homeowners insurance. Others commented that the incidental rule should only be used as a threshold calculation, or that insurers should be allowed to allocate personal/commercial hybrid policy premiums according to their normal business methods and procedures. One commenter contended that Homeowners policies should not be included in the Program regardless of the percentage of commercial premium, and that allocation of commercial/personal premium would not be appropriate for Farmowners or Farm Properties policies since they are both considered by some states to be commercial lines.

As discussed above, Treasury has suggested methods for the allocation of commercial portions of premiums in hybrid policies in an attempt to aid insurers by simplifying the adjustment and calculation of an insurer's DEP. If the appropriate premium was included in the DEP and the other required conditions for Federal payment are met, commercial portions of hybrid policies are covered by the Program. The 25 percent incidental provision was included in the interim final rule by Treasury to provide a threshold, so that those insurers that did not want to calculate an actual allocation of premiums on small incidental amounts of coverage, and did not intend to perfect their right to recover Federal payment on claims paid on such incidental commercial coverage, could then exclude those premiums from their DEP calculation if they wished to do so.

In order to clarify this in the final rule, and to make it clear that an insurer can choose to allocate premiums below that amount, Treasury has modified the language in section 50.5(d)(1)(i-iv) of the interim final rule.

Personal versus Commercial Lines

Four commenters asked for clarification with regard to whether coverage for one to four family rental units is personal or commercial insurance. One pointed out that such coverage is generally written under a Dwelling Properties insurance policy (which is considered to be a personal line). However, in other situations, under four family rental units are written as a commercial coverage. Treasury's designation in section 50.5(l)(1) of the interim final rule of the specific lines of commercial coverage from Statutory Page 14 was made, in part, to provide greater clarity for insurers in cases where various States may not treat certain types of coverage consistently as commercial coverage. In general, it is our understanding that premium income for one to four family rental unit insurance coverage generated from policies insuring property owned for business purposes (e.g. to generate income for the property owner) is reported on Lines 1 (Fire) 2.1 (Allied Lines) and 17 (Other Liability) of Statutory Page 14. Based on section 50.5(l)(1) of the final rule, such insurance coverage would be considered commercial property and casualty insurance coverage that is included in the Program. Treasury also addressed the issue of personal lines in the context of adjustments to DEP in section 50.5(d)(1) of the interim final rule and through adjustments to that section in the final rule. To the extent that one

to four family rental units have a personal coverage component, the suggested methods of adjusting and calculating the appropriate DEP may be used by an insurer.

Another commenter stated that farm residences should be considered commercial. For purposes of the Program, Treasury does not agree, but considers any owner occupied residence to be basically a personal coverage. Therefore, where a farm residence is covered in a hybrid farm policy, the suggested methods of adjusting and calculating the appropriate DEP can be utilized.

Other Non-Covered Lines

One commenter suggested that Treasury consider extending the commercial/personal allocation to other hybrid contracts containing premiums for excluded lines of coverage such as Medical Malpractice in combination with Hospital General Liability coverage. Such insurance lines are not within the scope of the definition of commercial property and casualty insurance of the Act and are not included in the Program. Therefore, premiums in hybrid policies applicable to those exceptions do not need to be included in an insurer's DEP. Any allocation of premium for such exclusions should be calculated by insurers either using methods suggested by Treasury, or other similar methods in accordance with the insurer's normal business methods and procedures.

Another commenter suggested that Treasury should exclude premiums reported on the specified lines on Statutory Page 14, but earned from retroactive insurance programs such as certain Novations, Adverse Development Cover, or Loss Portfolio Transfer Programs. Retroactive insurance is insurance covering only events that occurred prior to the inception date of the policy, but there appears to be no differentiation in the Statutory Page 14 reporting to indicate that such premiums relate to risks from prior years. Treasury takes the position that such retroactive premiums are not within the time period of the definition of “insured losses” if they are associated with losses that occurred prior to enactment and the effective date of the Act (November 26, 2002). Such premium income may be removed in an insurer’s calculation of its DEP. Treasury has modified the language in the final rule (section 50.5(d)(1)(i-iv) of the interim final rule) to clarify the nature of the allocation provisions with regard to hybrid policies and other policies with coverage of losses outside the scope of insured losses under the Program.

Fidelity Insurance

Treasury did not include Line 23 (Fidelity) of Statutory Page 14 in its list of specified lines considered to be commercial “property and casualty insurance” covered under the Act in its initial interim guidance or in its interim final rule. Comments were received from five different commenters, two in support of Treasury’s position, and three in opposition.

One of the commenters advocating the inclusion of fidelity insurance argued that it can also have a distinct property component as in cases where coverage is provided for the destruction of money and securities, such as those held in bank or corporate vaults. The commenter pointed out that it had losses associated with fidelity policies arising from the September 11 terrorist attacks totaling some \$20 million due to the destruction of cash on the premises of its insured. Another commenter emphasized that fidelity has always been considered by state regulators, insurers and policyholders to be a commercial property and casualty line.

Those opposed to the inclusion of fidelity insurance contend that it is a line of insurance that by itself faces low exposure to terrorism losses. One commenter had indicated previously that it had provided terrorism coverage for all of its fidelity policies prior to the Act, but needed to confirm whether fidelity insurance was covered under the Program in order to know how much reinsurance coverage would be needed to cover its deductible exposure. Commenters also pointed out that if Treasury were to reverse itself and now include fidelity insurance as a covered line, problems associated with the timing of the disclosure requirements and other issues would need to be addressed.

After considering the comments, Treasury has determined that fidelity insurance is not covered under the Act, and thus has *not* inserted Line 23 (Fidelity) in the specified lines on Statutory Page 14 that make up commercial property and casualty insurance covered under the Act. In making the overall determination of what lines of coverage are included and excluded in the definition of property and casualty insurance, Treasury

relied on specific guidance provided by Congress in section 102(12) of the Act. Section 102(12)(A) expressly includes excess insurance, workers' compensation insurance, and surety insurance. Traditional surety insurance and fidelity insurance share a similar characteristic in that they guarantee against losses associated with the performance of third parties. Treasury maintains the position that if Congress had intended fidelity insurance to be covered, it would have specifically included it as it did surety insurance. Treasury relied on a similar rationale for excluding group accident coverage, a line of coverage that shares some of the same risk characteristics as workers' compensation coverage, from the list of specified lines on Statutory Page 14 that make up commercial property and casualty insurance covered under the Act.

Through the comment process, Treasury has been made aware that the traditional fidelity insurance coverage has been expanded in recent years by some insurers to include coverage to non-employee "insiders," as well as to property coverage for loss of firm assets, including cash, due to crime. Although Treasury is making no change to the interim final rule definition with regard to fidelity in the final rule, Treasury will continue to evaluate this wrap-around or hybrid-type coverage which could include other types of coverage that are generally covered by the Act, but not reported as such. In this regard, Treasury will evaluate whether and how the designation of included and excluded lines has affected the availability of coverage for terrorism insurance risk, and whether any further change in the Program might be warranted.

Other DEP-Related Comments

On behalf of county or town mutual insurers that do not report on Statutory Page 14, one commenter suggested that Treasury’s suggestion that they convert direct premium or other types of payments such as assessments or contributions into DEP, would lead to inconsistencies in the Program because states have varying reporting requirements. The result would be that DEPs would vary significantly from state to state, which would be “bad from a public policy perspective, but leaves insurers on uncertain ground despite their best good faith efforts at compliance.” Treasury has consulted with the NAIC on this issue and we understand that the NAIC plans to develop a recommended conversion method that States in turn could recommend to county or town mutual insurers.

Another commenter requested that Treasury give insurers assurance that “fronted” premiums received by an insurer would not be included in DEP and thus raise its deductible, if the insurer assuming the risk (captive or otherwise) is also an insurer under the Program. The commenter explained that “fronting” is a credit enhancement procedure that is sometimes employed by business customers and their insurers to expand available insurance capacity, and is recognized by state regulators. However, fronting arrangements are not addressed in the Act, and the Act does not appear to provide any basis to exclude “fronted” premiums from DEP. If one insurer “fronts” for another by receiving premiums but passes the risk to another, it remains the “insurer” under the Act and the premiums it receives become part of its DEP. This is not unlike situations where primary insurers report DEP on policies that they subsequently reinsure, and reinsurance

is specifically excluded from the Act. Therefore, Treasury will *not* provide assurance that fronted premiums will not be included in DEP.

D. Insured Loss (Section 50.5.e)

Treasury incorporated the statutory definition of “insured loss” found in section 102(5) of the Act in section 50.5(e)(1) of the interim final rule. Section 50.5(e)(2) of the interim final rule clarified the meaning of insured loss as it relates to section 102(5)(B) of that Act as follows:

- (i) A loss that occurs to an air carrier (as defined in 49 U.S.C. 40102), to a United States flag vessel, or a vessel based principally in the United States, on which United States income tax is paid and whose insurance coverage is subject to regulation in the United States, is not an insured loss under section 102(5)(B) of the Act unless it is incurred by the air carrier or vessel outside the United States.
- (ii) An insured loss to an air carrier or vessel outside the United States under section 102(5)(B) of the Act does not include losses covered by third party insurance contracts that are separate from the insurance coverage provided to the air carrier or vessel.

One commenter took exception to Treasury’s clarification that such extraterritorial insured third party losses to United States air carriers and vessels are not insured losses, and cited legislative history of the Act to indicate an intent on the part of

Congress to provide extraterritorial coverage to United States air carriers and vessels without limitation.

After reviewing the comments including the legislative history cited by the commenter, Treasury has determined not to change the position it took in the interim final rule. Therefore, for purposes of the Program, an insured loss is “any” loss, including a third party liability loss, if it occurs within the geographic boundaries of the United States; but, if the loss occurs outside of the geographic boundaries of the United States (extraterritorial) to a United States air carrier or vessel, then only that portion of the loss “to” that air carrier or vessel is an insured loss eligible for the backstop. To further clarify, “to” in this context means insured losses that are incurred by United States air carriers and vessels (e.g., through United States air carriers’ or vessels’ property and liability insurance coverage), not losses that are incurred by other entities that are covered by third party insurance contracts that are separate from the insurance coverage provided to the air carrier or vessel.

Treasury’s position is consistent with how third party liability losses are generally treated under the Program (including how such losses are treated for foreign air carriers and foreign flag vessels) in that such losses would be considered insured losses if they are incurred within the geographic scope of the United States. The extension of coverage provided to United States air carriers and vessels under the Act is related directly to those entities and their potential insurance exposures, which are fully covered under the interim final rule. Treasury does not believe that granting broader third party indemnification on

an extraterritorial basis and creating greater exposure for United States taxpayers is consistent with congressional intent for the Program.

E. Insurer (Section 50.5.f)

The interim final rule incorporated the statutory definition of “insurer” as generally reflected in previously issued interim guidance that was published at 67 FR 78864. In accordance with section 103(a)(3) of the Act, each entity that meets the definition of “insurer” under the Act as implemented by Treasury must participate in the Program. To participate in the Program, an entity, including an “affiliate” of an insurer (see further discussion in part B of this preamble), must itself meet all of the requirements of section 102(6)(A) and (B) and, as the Treasury may prescribe, (C). This means that to be an insurer, an entity must: 1) fall within one of the categories in section 102(6)(A) described below; 2) receive direct earned premiums as required by section 102(6)(B); and 3) meet any additional criteria established by Treasury pursuant to section 102(6)(C).

The categories of insurers in Section 102(6)(A) that were directly addressed in the interim final rule include:

- (i) Licensed or admitted to engage in the business of providing primary or excess insurance in any State (“State” includes the District of Columbia and territories of the United States);

- (ii) Not so licensed or admitted, but is an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the National Association of Insurance Commissioners;
- (iii) Approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy or aviation activity; and
- (iv) A State residual market insurance entity or State workers' compensation fund.

The interim final rule provides that an entity that falls within two categories will be considered by Treasury to fall within the first category that it meets under section 102(6)(A)(i)-(iv). All entities that are licensed or admitted by a State's insurance regulatory authority, such as captive insurers, risk retention groups, and farm and county mutuals, fall under section 102(6)(A)(i).

The interim final rule also specified that the scope of insurance coverage (insured losses) under the Program for federally approved insurers under section 102(6)(A)(iii) is only to the extent of federal approval of the commercial property and casualty insurance coverage approved by the Federal agency in connection with maritime, energy or aviation activity. Therefore, insured losses under other insurance coverage that may be offered by a federally approved insurer under section 102(6)(A)(iii) would not be covered by the Program.

In addition to falling within a category in section 102(6)(A), an "insurer" must meet the requirements in section 102(6)(B) unless statutorily excepted. Therefore, an

“insurer” must receive “direct earned premiums” (as defined) on any type of commercial property and casualty insurance (as defined). In addition, an “insurer” must meet any additional criteria prescribed by Treasury under section 102(6)(C). The interim final rule did not prescribe additional criteria under section 102(6)(C). However, under a separate notice of proposed rulemaking published at 68 FR 9814 Treasury solicited public comment on whether the Secretary should prescribe other criteria for certain insurers pursuant to the authority provided by section 102(6)(C) and, if so, what criteria Treasury should prescribe.

Captive Insurers

Treasury received six comments that addressed the treatment of captive insurers under the Program. The majority of these objected to Treasury’s mandatory inclusion of captive insurers as a State licensed or approved insurer under Section 102(6)(A)(i). These commenters suggested that captives should be allowed to opt-in to the Program as opposed to being mandatory participants. In support of this position, commenters offered the following points: many captive insurers were created to operate outside of the traditional insurance marketplace, and thus they should not be treated as other insurance companies; some types of commercial coverage provided by captive insurers may have little or no exposure to terrorism risk, thus captive insurers should not be subject to the Act’s potential recoupment provisions; and mandatory participation requirements for captives, in particular the Act’s potential recoupment provisions, could negatively affect

the formation of domestic captives as companies may find setting up off-shore captives to be advantageous.

Treasury received one comment letter in support of treating State licensed or admitted captive insurers as mandatory participants under the Program. Treasury also received a comment letter from the NAIC that described a split view on the part of State regulators over mandatory participation requirements for state-licensed or admitted captive insurers. Although the NAIC's comments included some of the points noted above, the NAIC also acknowledged that allowing opt-in treatment for captive insurers could allow for adverse selection and could set a bad precedent as other entities would seek similar treatment. In addition, the NAIC noted that "when pressed for a decision regarding whether a complete inclusion is better than a complete exclusion for captives, regulators generally agree that inclusion is preferable."

Treasury disagrees with the suggestion in some comments that captive insurers should be provided with opt-in treatment. Requiring mandatory participation for State licensed or admitted captive insurers is in accord with the plain language of section 102(6)(A)(i) where no distinction is made regarding types of State licensed or admitted insurers. This treatment also furthers other statutory objectives such as ensuring that policyholders have widespread access to the terrorism risk insurance benefits of the Program, and spreading potential costs of the Program associated with any federal loss-sharing payments. For example, the cost spreading provisions in connection with recoupment as required by section 103(e)(7) and in connection with surcharges as

required by section 103(e)(8) are to be applied to all commercial property and casualty policyholders.

As it relates to the overall administration of the Program, allowing for opt-in treatment would create the potential for adverse selection within the Program as those captive insurers that perceived themselves to have higher risk to terrorism would likely opt-in to the Program while others with lower perceived risks would likely opt-out of the Program. A major consequence of this type of action would be the potential policyholder recoupment base would be reduced, which in turn would increase the potential recoupment costs on the policyholders of other mandatory participants in the Program.

Treasury does not support the view set forth by some of the commenters that limited risk exposure to terrorism of the coverage provided by some captive insurers is a reason to provide for an opt-in option. This same type of argument could be made by any number of insurers and policyholders that feel they have limited risk exposure to terrorism. Because the recoupment base applies to all commercial property and casualty policyholders, potentially limited risk exposure to terrorism is not a valid reason to limit participation under the Program.

Treasury also finds little or no support for assertions that the potential recoupment provisions of the Act would have an adverse effect on U.S. domestic captive jurisdictions. It should be noted that any such recoupment would only be imposed in the case of a terrorist event that triggers Federal payments under the Program, and that any

potential recoupment is limited to a maximum 3 percent of premium surcharge in any given year. Although it is possible that certain state-licensed or admitted captive insurers would find these potential costs unattractive and search out other jurisdictions, other state-licensed or admitted captive insurers would recognize the benefits of Program participation. Therefore, the ultimate effect on any particular captive insurance jurisdiction is difficult to quantify.

In addition to the general comments on providing captive insurers opt-in treatment under the Program, two members of Congress offered the view that, in the case of captives, the Act must be read in the context of section 103(f). This section authorizes (but does not require) Treasury to apply the provisions of the Act to “other” classes or types of captive insurers. These commenters believe that the use of the word “other” in section 103(f) is a grammatical error in the Act and, for that reason, they contend that Treasury’s interim final rule does not reflect the intent of Congress to create a process through which captive insurers could be integrated into the Program on an opt-in basis.

As previously noted, Section 102(6)(A)(i) of the Act mandates participation by insurers that are “licensed or admitted” by a State to engage in the business of providing property and casualty insurance. Following this state-licensed or admitted category in the definition of “insurer”, is a category for “any *other* entity described in Section 103(f), to the extent provided in the rules of the Secretary issued under section 103(f).” (emphasis added). Section 103(f) of the Act gives discretionary authority to the Secretary to add to the Program, “*other* classes or types of captive insurers ...”(emphasis added). A key

principle of statutory construction is that words in a statute must be read to have meaning unless the reading of those words produces an absurd result. The bar for interpreting words in a statute to be a legislative error is extremely high. If the words in a statute can be construed as having a rational meaning, then the rules of statutory construction preclude an interpretation that they were enacted by Congress in error.

In this case, the word “other” in these two provisions can be easily construed as referring to captives *other than those that are State-licensed or admitted*. Adopting the interpretation of legislative error suggested by the two commenters would require the conclusion that Congress erred in two places in the Act. In addition, we found nothing in the Act’s language or legislative history that would support treating state-licensed or admitted captives differently from other state-licensed or admitted insurers for purposes of the Program. For these reasons, the definition of “insurer” in the final rule, as in the interim final rule, includes those entities, including any captives, that are state-licensed or admitted. Therefore, if a captive is *not* state licensed or admitted, then it is *not* in the Program, unless subsequently brought in by any rules issued under section 103(f).

Pooling Arrangements and Joint Underwriting Associations

Treasury received comments requesting clarification on how insurance pooling arrangements, such as joint underwriting associations, are treated under the Act. These commenters found the interim final rule and previously issued interim guidance to be unclear with regard to a) whether such entities are insurers under the Act, and b) if they

are insurers, the category of insurer under which they would belong (*e.g.*, State licensed or admitted, or federally approved). These commenters suggested that Treasury either clarify that State authorized joint underwriting associations are State licensed and admitted insurers under the Act, or directly inform a joint underwriting association of its status under the Act. Some commenters also suggested that Treasury's treatment of federally approved insurers (see next section) should be broadened to include all types of coverage provided by this category of insurers.

The issue of Treasury's treatment of federally approved insurers is, for the most part, separable from fundamental question of whether joint underwriting associations are State licensed or admitted insurers. With regard to joint underwriting associations operating in the United States, if such entities are considered to be State licensed or approved insurers, then they must participate in the Program as insurers in this category under the Act. The federally approved issue is not reached in this situation.

Treasury acknowledges that certain joint underwriting associations and other entities may not fit neatly within what is traditionally thought of as the "State licensed or admitted" market. To provide more clarity in the category of "State licensed or admitted," the final rule provides that, with regard to joint underwriting associations and other pooling arrangements, such entities must meet all three of the following criteria to be an insurer under the Program:

- An entity must have gone through a process to be licensed or admitted to engage in the business of providing primary or excess insurance that is administered by the State's insurance regulator. If such a process differs from what a State's insurance regulator generally applies to insurance companies, such a process should be similar in scope and content;
- An entity must generally be subject to State insurance regulation (including financial reporting requirements) applicable to insurance companies within the State; and
- An entity must be managed independently from other insurers that are participating in the Program.

If a joint underwriting association, pooling arrangement or other entity is still uncertain of its status as State licensed or admitted insurers under the Program, such entities are encouraged to provide Treasury with an explanation of their particular circumstances and how the criteria listed above apply or do not apply. After reviewing this information, Treasury will directly contact such entities regarding their status under the Program. These Treasury decisions also will be made available to the public.

Federally Approved Insurers

Treasury received fifteen comments regarding Treasury's treatment of federally approved insurers in the interim final rule. Under the interim final rule, the scope of insurance coverage ("insured losses") for federally approved insurers is only to the extent of federal approval of the commercial property and casualty insurance coverage approved by the Federal Agency in connection with maritime, energy or aviation activity. Most of these commenters contended that Treasury's interpretation regarding the scope of insurance coverage under the Program for federally approved insurers was too narrow and that such an interpretation was counter to the intent of Congress.

The maritime shipping industry and their mutually owned insurance companies (International Group of Protection and Indemnity Clubs) raised particular concerns that Treasury's interpretation regarding federally approved insurers would unduly limit access to the Program for the United States and world shipping fleets. As it relates to the maritime industry, the United States Maritime Administration (MARAD) has in place various mechanisms to approve underwriters providing insurance coverage for vessels built or operated with subsidy or covered by vessel obligation guarantees issued pursuant to Title XI of the Merchant Marine Act, 1936, as amended. (46 U.S.C. 1271-1279). Commenters noted that vessels built with Title XI subsidies or guarantees make up a small portion of the United States flag fleet. Therefore, to the extent that the portion of United States flag fleet not subject to MARAD insurance approval was relying solely on federally approved insurers for their insurance coverage, such vessels would currently have limited access to federal payments under the Program. Commenters also noted that

a similar situation exists to the extent that foreign flag vessels are currently relying on federally approved insurers for their insurance coverage.

MARAD has set forth eligibility criteria for underwriters of marine hull insurance at 46 CFR 249.4 and 249.5. Broadly speaking, to be eligible under the MARAD program an insurer must be: licensed to do business in the United States; an underwriter at Lloyd's; a member company of the Institute of London Underwriters; or specifically approved by MARAD. There is a fair degree of overlap between MARAD's eligibility criteria for Marine Hull insurers and the definition of "insurer" under the Act. Under sections 102(6)(A)(i-iv), the Act includes entities that are State licensed or admitted and entities that are listed on the Quarterly Listing of Alien Insurers of the NAIC as "insurers" under the Act. These insurers participate in the Program for all coverages that fall within the definition of "commercial property and casualty" within the scope of the definition of "insured loss" under the Act. Thus, insurers that fall within the first three of MARAD's eligibility criteria are for the most part already eligible insurers under the Act (although there may be some uncertainty regarding the Institute of London Underwriters as it is our understanding that this group has merged with another organization to form the International Underwriting Association). For insurers that MARAD specifically approves as Marine Hull underwriters, based on the most recently available lists (NAIC's Quarterly Listing of Alien Insurers – April 1, 2003, and MARAD Approval List – May 16, 2003), 13 out of the 18 MARAD approved insurers were listed on the NAIC's Quarterly Listing of Alien Insurers, and 1 of the 5 insurers that were not currently on the NAIC's Quarterly Listing of Alien Insurers was on the list in recent years. Thus, as it

relates to Marine Hull underwriters, Treasury's interpretation with regard to federally approved insurers does not appear to have caused major disruptions in insurance coverage. Treasury also notes that we did not receive any comments directly from Marine Hull underwriters objecting to the treatment of federally approved insurers.

MARAD, as part of its general insurance information and requirements, also accepts the International Group of Protection and Indemnity Clubs (International Group) as providers of liability coverage. The International Group is made up of 13 independent Protection and Indemnity Clubs. Each club is independently owned by its ship-owner members. The International Group allows for the individual clubs to share claims, purchase reinsurance as a group, and coordinate on maritime public policy issues. Unlike the case with MARAD-approved hull insurance underwriters, of the 13 members of the International Group only two qualify as eligible insurers under the Act in a category separate from the federally approved insurer category. Hence, the bulk of the comments Treasury received from the maritime community focused on the treatment of the International Group under the interim final rule.

Treasury also received similar comments from the offshore oil and gas drilling industry objecting to the interim final rule's interpretation regarding the participation of federally approved insurers under the Act. The Department of Interior's Minerals Management Service approves insurance coverage as one method covered offshore facilities can use for demonstrating oil spill financial responsibility, and the Minerals Management Service has procedures in place (30 CFR 253.29) regarding eligibility

criteria under their program. To further understand the oil and gas drilling industry's concerns, the Minerals Management Service provided Treasury with a list of insurers that had been approved to provide coverage under the oil spill financial responsibility program. Treasury, in consultation with the NAIC, identified 102 out of 105 insurers that were approved by the Minerals Management Service as being eligible participants under the Act because they either were State licensed or admitted or were on the NAIC's Quarterly Listing of Alien Insurers. Thus, as it relates to insurance coverage for offshore drilling interests, Treasury's interpretation with regard to federally approved insurers does not appear to have caused disruptions in insurance coverage. Treasury did not receive any comments from insurers providing coverage for offshore drilling interests objecting to the treatment of federally approved insurers.

Treasury also received comments regarding the treatment of federally approved insurers under the Department of Labor's authority to authorize workers' compensation coverage under the Longshore and Harbor Worker's Act (33 USC 901) and its extensions. The Department of Labor authorizes both insurance carriers (20 CFR 703.101) and self-insurers (20 CFR 703.301) for the purpose of meeting the requirements of the Longshore and Harbor Worker's Act. Insurers that are authorized under 20 CFR 703.101 clearly meet the criteria of section 50.5(f)(1)(C) of being "approved or accepted for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy, or aviation activity." In this regard a key element is that such insurers are "offering" insurance coverage.

In contrast, the Department of Labor and other Federal agencies may approve self insurance as an acceptable means of meeting the financial requirements or responsibilities of their respective programs. In this regard, self insurance is just another means of establishing financial responsibility and is not a substitute for the requirement that insurance is being “offered.” Thus, self insurance arrangements approved by Federal agencies are not included under section 50.5(f)(1)(C). However, Treasury may consider self insurance arrangements for inclusion in the Program through Treasury’s general authority to consider such arrangements under section 102(6)(A)(v) of the Act, which is also described in section 50.5(f)(1)(E) of the interim final rule. Treasury has not yet taken any action regarding the inclusion of self insurance arrangements under the Act.

In addition to the general concerns noted above regarding the treatment of federally approved insurers, airline insurance pools and other commenters (e.g., those addressing issues related to nuclear insurers) noted that Federal approval may be for amounts of insurance coverage that is less than what is normally provided by the insurance industry. For example, commenters noted that standard airline liability limits are \$1.5 billion, while the Federal Aviation Administration’s required liability coverage is much lower. Likewise, commenters noted that policy limits on nuclear property coverage generally exceed the mandated requirements of \$1.06 billion per licensee.

After consideration of these comments by the maritime industry and their mutually owned insurance companies and others, Treasury has decided not to make any

changes to the interim final rule's treatment of federally approved insurers for the following reasons.

First, the interim final rule's treatment of federally approved insurers is in accord with the statutory language of the Act in section 102(6)(A)(iii) ("*approved for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy or aviation activity*"). While some commenters pointed to congressional intent supporting a broader interpretation, no express language in the Act's legislative history supports this view. Moreover, Treasury's treatment of federally approved insurers in the interim final rule is consistent with the underlying reason for the Federal government providing Federal agencies with the authority to approve insurers. In general, the Federal government provides agencies with approval authority to address important national interests or to protect the Federal government's interests. For example, the Federal government requires that airlines maintain a minimum amount of liability insurance coverage. In contrast, the Federal government has no similar overall liability requirements for ocean going vessels, but such vessels are required to demonstrate financial responsibility for oil spills. As an example of protecting the Federal government's interest, MARAD approves insurance coverage for vessels that were built with a government subsidy or guarantee. MARAD could have been granted broader insurance approval authority than just federally subsidized vessels if there were a clear national interest in ensuring that all ocean going vessels in U.S. waters had adequate overall liability insurance coverage.

Second, Treasury's treatment of federally approved insurers is consistent with Treasury's consideration of a pre-existing nexus (for example, the nexus of State-licensing or NAIC approval for listing on the Quarterly Listing of Alien Insurers) to be very important to the effective and efficient administration of the Program. Some commenters criticized Treasury for not more fully explaining the importance of this consideration.

The following three key factors highlight the importance of a pre-existing regulatory nexus or structure for the administration of the Program.

Ongoing Data Requirements. As Program administrator, Treasury has chosen not to impose new ongoing data reporting requirements on insurers. That does not mean that validating and collecting certain data is not important to the Program. The calculation of an insurer's DEP forms the basis for an insurer calculating its deductible under the Program, and in the event that insurers would submit a claim for payment under the Program, Treasury would expect to validate an insurer's calculation of its deductible. Treasury believes that the existing ongoing data reporting requirements of the State insurance regulators and the consolidated reporting requirements as implemented by the NAIC form a sound basis for the administration of the Program. Therefore, there was not a pressing need to implement new ongoing data reporting requirements through Treasury (and to create additional paperwork burdens for the insurance industry) for this temporary government Program.

However, such ongoing data is useful and important, especially as it relates to foreign insurers that are providing coverage on global risk policies. Global risk policies (e.g., such as those provided to ocean going vessels) have historically not allocated premium income to reflect the scope of insured losses covered under the Act, which is a key measure in calculating an insurer's deductible. Treasury has determined to utilize data collected by the NAIC from insurers on the Quarterly Listing of Alien Insurers that captures the amount of premium income related to the scope of insured loss under the Act. Federal agencies approving insurers under section 102(6)(A)(iii), while generally having some type of financial criteria for approving insurers, do not have in place any type of ongoing data reporting requirements similar to that of the NAIC.

Ability to Impose Surcharges or Take Enforcement Actions. Many of the insurers approved by Federal agencies may be outside the direct jurisdiction of the United States. Treasury has little leverage vis a vis these insurers and this could make it difficult for Treasury to impose surcharges in the case of any recoupment under the Act or to take enforcement actions if needed. In contrast, if an insurer on the NAIC's Quarterly Listing of Alien Insurers is not in compliance with provisions of the Act, the insurer could suffer the consequences of losing its NAIC listing for poor character, which in turn could adversely affect its U.S. business operations. It is possible that a Federal agency could also revoke approval for noncompliance with provisions of the Act. However, the limited nature of a Federal agency's

approval authority could somewhat lessen the impact of any such action and Treasury has no authority to require such action by another federal agency.

Comparability among Federally Approved Insurers. Treasury strongly believes that all federally approved insurers should be treated in a similar manner that is consistent with the statute. For example, such consistency implies that the mandatory participation requirements of the Act should be applied to all federally approved insurers in a similar fashion. In that regard, Treasury would find it difficult to justify one group of federally approved insurers having broader access to the Program than the current interim final rule provides, while other groups stayed with the current approach in the interim final rule.

Treasury has considered carefully the concerns raised by commenters regarding the interim final rule's treatment of federally approved insurers. At this time, Treasury has decided that no changes to the rule are warranted. It appears that many of the insurers that have been approved by a Federal agency also qualify to participate in the Program based on other criteria. Treasury also notes that obtaining a listing on the NAIC's Quarterly Listing of Alien Insurers is an option that insurers can employ if they are not satisfied with the treatment of federally approved insurers under the interim final rule. Obtaining such a listing would satisfy the concerns we noted above, while at the same time imposing limited burden on insurers. It is our understanding that perhaps the major obstacle to obtaining a listing is setting up the necessary trust fund.

Treasury will continue to evaluate this issue as the Program matures. While Treasury does not plan on making any changes to the treatment of federally approved insurers at this time, Treasury would be open to considering alternatives if the three key factors listed above – ongoing data reporting requirements, ability to impose surcharges or take enforcement actions, and comparability among federally approved insurers – could be addressed.

Other Insurer Criteria

Under a separate notice of proposed rulemaking published at 68 FR 9814 Treasury solicited public comment on whether the Secretary should prescribe other criteria for certain insurers pursuant to the authority provided by section 102(6)(C) and, if so, what criteria Treasury should prescribe. Specifically, Treasury solicited comment on whether criteria should be developed to prevent newly formed insurance companies from participating in the Program if such companies were established for the purpose of evading the Act's deductible requirements.

A few commenters raised concerns that developing such criteria could limit the development of new structures to provide terrorism risk insurance coverage. One commenter acknowledged the concerns raised by Treasury and supported the interim final rule's treatment of the deductible requirements for newly formed insurance companies in section 50.5(g)(2) as an appropriate safeguard. Another commenter suggested a set of general criteria that Treasury could look to as it considers this issue.

As Treasury noted in the preamble to interim final rule, we are seeking to balance the goals of encouraging new sources of capital in the market for terrorism risk insurance while also maintaining the integrity of the Program. Treasury is not proposing any additional criteria at this time, but we will continue to monitor developments in the market for terrorism risk insurance and the market's response to the Act.

Treasury also solicited comments on whether additional criteria should be proposed for federally approved insurers. Some commenters suggested that additional financial criteria could be applied if necessary, while one commenter suggested that the Act does not give Treasury the authority to regulate insurance. Given that the final rule retains the interim final rule's treatment of federally approved insurers, the scope of potential problems related to the financial integrity of such insurers is somewhat limited. Thus, Treasury is not proposing any additional criteria at this time, but we will continue to study and monitor this issue.

F. Insurer Deductible (Section 50.5.g)

The interim final rule incorporated the statutory definition of "insurer deductible" found in section 102(7) of the Act and set forth a procedure specifying how newly formed insurance companies would calculate their deductible under the Program. In particular, the interim final rule specified that for an insurer that came into existence after November 26, 2002, the insurer deductible will be based on data for direct earned premiums for the current Program Year. If the insurer has not had a full year of

operations during the applicable Program Year, the direct earned premiums for the current Program Year will be annualized to determine the insurer deductible.

The two commenters who addressed this issue both indicated support for Treasury's determination that premiums for new insurers would be annualized in the calculation of their insurer deductible, and the language of the interim final rule is incorporated without change into the final rule.

III. Procedural Requirements

The Act established a Program to provide for loss sharing payments by the Federal Government for insured losses resulting from certified acts of terrorism. The Act became effective immediately upon the date of enactment (November 26, 2002). Preemptions of terrorism risk exclusions in policies, mandatory participation provisions, disclosure and other requirements and conditions for federal payment contained in the Act applied immediately to those entities that come within the Act's definition of "insurer." Treasury has issued and will be issuing additional regulations to implement the Program. This final rule provides critical information concerning the definitions of Program terms that lays the groundwork for Treasury's implementation of the Program. No one can predict if, or when, an act of terrorism may occur. There is an urgent need for Treasury, as Program administrator, to lay the groundwork for Program implementation through regulations to provide clarity and certainty concerning which entities are required to participate in the Program; the scope and conditions of Program

coverage; and other implementation issues that immediately affect insurers, their policyholders, State regulators and other interested parties. This includes the need to supplement, or modify as necessary, the previously issued interim final rule.

Accordingly, pursuant to 5 U.S.C. 553(d)(3), Treasury has determined that there is good cause for the final rule to become effective immediately upon publication.

This final rule is a significant regulatory action and has been reviewed by the Office of Management and Budget under the terms of Executive Order 12866.

It is hereby certified that this final rule will not have a significant economic impact on a substantial number of small entities. The Act requires all licensed or admitted insurers to participate in the Program. This includes all insurers regardless of size or sophistication. The Act also defines property and casualty insurance to mean commercial lines without any reference to the size or scope of the commercial entity. Although the Act affects small insurers, the final rule also gives insurers flexibility in calculating their direct earned premium for policies that have both commercial and personal exposures, and it provides a safe harbor to exclude policies that have incidental coverage for commercial purposes. Accordingly, any economic impact associated with the final rule flows from the Act and not the final rule. However, the Act and the Program are intended to provide benefits to the U. S. economy and all businesses, including small businesses, by providing a federal reinsurance backstop to commercial property and casualty insurance policyholders and spreading the risk of insured loss resulting from an act of terrorism.

The collection of information contained in § 50.8 of this final rule has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3507(j)) under control number 1505-0190. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by OMB.

This information is required in order for Treasury to determine whether an insurer has rebutted a presumption that the insurer exercises a controlling influence over the management or policies of another insurer. The collection of information is mandatory with respect to an insurer seeking to rebut a presumption. The estimated average burden associated with the collection of information in this final rule is 40 hours per respondent.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Office of Financial Institutions Policy, Room 3160 Annex, Department of the Treasury, 1500 Pennsylvania Ave., N.W., Washington, DC 20220 and to OMB, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

List of Subjects in 31 CFR Part 50

Terrorism risk insurance.

Authority and Issuance

For the reasons set forth above, the interim final rule adding 31 CFR Part 50, which was published at 68 FR 9804 on February 28, 2003, is adopted as a final rule with the following changes:

PART 50 – TERRORISM RISK INSURANCE PROGRAM

1. The authority citation for 31 CFR Part 50 continues to read as follows:

Authority: 5 U.S.C. 301; 31 U.S.C. 321; Title I, Pub. L. 107-297, 116 Stat. 2322 (15 U.S.C. 6701 note).

2. Section 50.2 is added to read as follows:

§ 50.2 Responsible office.

The office responsible for the administration of the Terrorism Risk Insurance Act in the Department of the Treasury is the Terrorism Risk Insurance Program Office. The Treasury Assistant Secretary for Financial Institutions prescribes the regulations under the Act.

3. Section 50.5(c), (d)(1), (f)(1), and (l) are revised to read as follows:

§ 50.5 Definitions.

* * * * *

(c)(1) Affiliate means, with respect to an insurer, any entity that controls, is controlled by, or is under common control with the insurer. An affiliate must itself meet the definition of insurer to participate in the Program.

(2) For purposes of paragraph (c)(1) of this section, an insurer has control over another insurer for purposes of the Program if:

- (i) The insurer directly or indirectly or acting through one or more other persons owns, controls, or has power to vote 25 percent or more of any class of voting securities of the other insurer;
- (ii) The insurer controls in any manner the election of a majority of the directors or trustees of the other insurer; or
- (iii) The Secretary determines, after notice and opportunity for hearing, that an insurer directly or indirectly exercises a controlling influence over the management or policies of the other insurer, even if there is no control as defined in paragraph (c)(2)(i) or (c)(2)(ii) of this section.

(3) An insurer described in paragraph (c)(2)(i) or (c)(2)(ii) of this section is conclusively deemed to have control.

(4) For purposes of a determination of controlling influence under paragraph (c)(2)(iii) of this section, if an insurer is not described in paragraph (c)(2)(i) or (c)(2)(ii) of this section, the following rebuttable presumptions will apply:

(i) If an insurer controls another insurer under any State law, and at least one of the factors listed in paragraph (c) (4)(iv) of this section applies, there is a rebuttable presumption that the insurer that has control under State law exercises a controlling influence over the management or policies of the other insurer for purposes of paragraph (c)(2)(iii) of this section.

(ii) If an insurer provides 25 percent or more of another insurer's capital (in the case of a stock insurer), policyholder surplus (in the case of a mutual insurer), or corporate capital (in the case of other entities that qualify as insurers), and at least one of the factors listed in paragraph (c)(4)(iv) of this section applies, there is a rebuttable presumption that the insurer providing such capital, policyholder surplus, or corporate capital exercises a controlling influence over the management or policies of the receiving insurer for purposes of paragraph (c)(2)(iii) of this section.

(iii) If an insurer, at any time during a Program Year, supplies 25 percent or more of the underwriting capacity for that year to an insurer that is a syndicate consisting of a group including incorporated and individual unincorporated underwriters, and at least one of the factors in paragraph (c)(4)(iv) of this section applies, there is a rebuttable presumption that the insurer exercises a controlling influence over the syndicate for purposes of paragraph (c)(2)(iii) of this section.

(iv) If paragraphs (c)(4)(i) through (c)(4)(iii) of this section are not applicable, but two or more of the following factors apply to an insurer, with respect to another insurer, there is

a rebuttable presumption that the insurer exercises a controlling influence over the management or policies of the other insurer for purposes of paragraph (c)(2)(iii) of this section:

- (A) The insurer is one of the two largest shareholders of any class of voting stock;
- (B) The insurer holds more than 35 percent of the combined debt securities and equity of the other insurer;
- (C) The insurer is party to an agreement pursuant to which the insurer possesses a material economic stake in the other insurer resulting from a profit-sharing arrangement, use of common names, facilities or personnel, or the provision of essential services to the other insurer;
- (D) The insurer is party to an agreement that enables the insurer to influence a material aspect of the management or policies of the other insurer;
- (E) The insurer would have the ability, other than through the holding of revocable proxies, to direct the votes of more than 25 percent of the other insurer's voting stock in the future upon the occurrence of an event;
- (F) The insurer has the power to direct the disposition of more than 25 percent of a class of voting stock of the other insurer in a manner other than a widely dispersed or public offering;
- (G) The insurer and/or the insurer's representative or nominee constitute more than one member of the other insurer's board of directors; or
- (H) The insurer or its nominee or an officer of the insurer serves as the chairman of the board, chairman of the executive committee, chief executive officer, chief operating

officer, chief financial officer or in any position with similar policymaking authority in the other insurer.

(5) An insurer that is not described in paragraph (c)(2)(i) or (c)(2)(ii) of this section may request a hearing in which the insurer may rebut a presumption of controlling influence under paragraph (c)(4)(i) through (c)(4)(iv) of this section or otherwise request a determination of controlling influence by presenting and supporting its position through written submissions to Treasury, and in Treasury's discretion, through informal oral presentations, in accordance with the procedure in § 50.8.

(d) * * *

(l) State licensed or admitted insurers. For a State licensed or admitted insurer that reports to the NAIC, direct earned premium is the premium information for commercial property and casualty insurance coverage reported by the insurer on column 2 of the NAIC Exhibit of Premiums and Losses of the Annual Statement (commonly known as Statutory Page 14). (See definition of property and casualty insurance).

(i) Premium information as reported to the NAIC should be included in the calculation of direct earned premiums for purposes of the Program only to the extent of commercial property and casualty coverage issued by the insurer against an insured loss under the Program.

(ii) Premiums for personal property and casualty insurance coverage (coverage primarily designed to cover personal, family or household risk exposures, with the exception of coverage written to insure 1 to 4 family rental dwellings owned for the business purpose of generating income for the property owner) or for insurance coverage for any loss that would not be an insured loss under the Program, should be excluded in the calculation of direct earned premiums for purposes of the Program.

(iii) Personal property and casualty insurance coverage that includes incidental coverage for commercial purposes is primarily personal coverage, and therefore premiums may be fully excluded by an insurer from the calculation of direct earned premium. For purposes of the Program, commercial coverage is incidental if less than 25 percent of the total direct earned premium is attributable to commercial coverage. Property and casualty insurance coverage for any loss that would not be an insured loss under the Program that includes incidental coverage for an insured loss under the Program is primarily non-Program coverage, and therefore premiums may be fully excluded by an insurer from the calculation of direct earned premium. For purposes of the Program, coverage for an insured loss is incidental if less than 25 percent of the total direct earned premium is attributable to such coverage.

(iv) If a property and casualty insurance policy covers both commercial and personal risk exposures, insurers may allocate the premiums in accordance with the proportion of risk between commercial and personal components in order to ascertain direct earned premium. If a property and casualty insurance policy covers risk exposures for both

insured losses and losses that would not be insured losses under the Program, insurers may allocate the premiums in accordance with the proportion of risk between the insured loss and non-insured loss components in order to ascertain direct earned premium.

* * * * *

(f) Insurer means any entity, including any affiliate of the entity, that meets the following requirements:

(1)(i) The entity must fall within at least one of the following categories:

(A) It is licensed or admitted to engage in the business of providing primary or excess insurance in any State, (including, but not limited to, State licensed captive insurance companies, State licensed or admitted risk retention groups, and State licensed or admitted farm and county mutuals), and, if a joint underwriting association, pooling arrangement, or other similar entity, then the entity must:

(1) Have gone through a process of being licensed or admitted to engage in the business of providing primary or excess insurance that is administered by the State's insurance regulator, which process generally applies to insurance companies or is similar in scope and content to the process applicable to insurance companies;

(2) Be generally subject to State insurance regulation, including financial reporting requirements, applicable to insurance companies within the State; and

(3) Be managed independently from other insurers participating in the Program;

(B) It is not licensed or admitted to engage in the business of providing primary or excess insurance in any State, but is an eligible surplus line carrier listed on the Quarterly Listing of Alien Insurers of the NAIC, or any successor to the NAIC;

(C) It is approved or accepted for the purpose of offering property and casualty insurance by a Federal agency in connection with maritime, energy, or aviation activity, but only to the extent of such federal approval of commercial property and casualty insurance coverage offered by the insurer in connection with maritime, energy, or aviation activity;

(D) It is a State residual market insurance entity or State workers' compensation fund; or

(E) As determined by the Secretary, it falls within any other class or type of captive insurer or other self-insurance arrangement by a municipality or other entity, to the extent provided in Treasury regulations issued under section 103(f) of the Act.

(ii) If an entity falls within more than one category described in paragraph (f)(1)(i) of this section, the entity is considered to fall within the first category within which it falls for purposes of the Program.

* * * * *

(l) Property and casualty insurance means commercial lines of property and casualty insurance, including excess insurance, workers' compensation insurance, and surety insurance, and

(1) Means commercial lines within only the following lines of insurance from the NAIC's Exhibit of Premiums and Losses (commonly known as Statutory Page 14): Line 1—Fire; Line 2.1—Allied Lines; Line 3—Farmowners Multiple Peril; Line 5.1—Commercial Multiple Peril (non-liability portion); Line 5.2—Commercial Multiple Peril (liability portion); Line 8—Ocean Marine; Line 9—Inland Marine; Line 16—Workers' Compensation; Line 17—Other Liability; Line 18—Products Liability; Line 19.3—Commercial Auto No-Fault (personal injury protection); Line 19.4—Other Commercial Auto Liability; Line 21.2—Commercial Auto Physical Damage; Line 22—Aircraft (all perils); Line 24—Surety; Line 26—Burglary and Theft; and Line 27—Boiler and Machinery; and

(2) Does not include:

(i) Federal crop insurance issued or reinsured under the Federal Crop Insurance Act (7 U.S.C. 1501 et seq.), or any other type of crop or livestock insurance that is privately issued or reinsured (including crop insurance reported under either Line 2.1—Allied

Lines or Line 2.2—Multiple Peril (Crop) of the NAIC’s Exhibit of Premiums and Losses (commonly known as Statutory Page 14);

(ii) Private mortgage insurance (as defined in section 2 of the Homeowners Protection Act of 1988 (12 U.S.C. 4901) or title insurance;

(iii) Financial guaranty insurance issued by monoline financial guaranty insurance corporations;

(iv) Insurance for medical malpractice;

(v) Health or life insurance, including group life insurance;

(vi) Flood insurance provided under the National Flood Insurance Act of 1968 (42 U.S.C. 4001 et seq.) or earthquake insurance reported under Line 12 of the NAIC’s Exhibit of Premiums and Losses (commonly known as Statutory Page 14); or

(vii) Reinsurance or retrocessional reinsurance.

* * * * *

4. Section 50.8 is added to Subpart A to read as follows:

§ 50.8 Procedure for requesting determinations of controlling influence.

(a) An insurer or insurers not having control over another insurer under § 50.5(c)(2)(i) or (c)(2)(ii) may make a written submission to Treasury to rebut a presumption of controlling influence under § 50.5(c)(4)(i) through (iv) or otherwise to request a determination of controlling influence. Such submissions shall be made to the Terrorism Risk Insurance Program Office, Department of the Treasury, Suite 2110, 1425 New York Ave NW, Washington, D.C. 20220. The submission should be entitled, “Controlling Influence Submission,” and should provide the full name and address of the submitting insurer(s) and the name, title, address and telephone number of the designated contact person(s) for such insurer(s).

(b) Treasury will review submissions and determine whether Treasury needs additional written or orally presented information. In its discretion, Treasury may schedule a date, time and place for an oral presentation by the insurer(s).

(c) An insurer or insurers must provide all relevant facts and circumstances concerning the relationship(s) between or among the affected insurers and the control factors in § 50.5(c)(4)(i) through (iv); and must explain in detail any basis for why the insurer believes that no controlling influence exists (if a presumption is being rebutted) in light of the particular facts and circumstances, as well as the Act’s language, structure and purpose. Any confidential business or trade secret information submitted to Treasury should be clearly marked. Treasury will handle any subsequent request for information

designated by an insurer as confidential business or trade secret information in accordance with Treasury's Freedom of Information Act regulations at 31 C.F.R. Part 1.

(d) Treasury will review and consider the insurer submission and other relevant facts and circumstances. Unless otherwise extended by Treasury, within 60 days after receipt of a complete submission, including any additional information requested by Treasury, and including any oral presentation, Treasury will issue a final determination of whether one insurer has a controlling influence over another insurer for purposes of the Program. The determination shall set forth Treasury's basis for its determination.

(e) This § 50.8 supersedes the Interim Guidance issued by Treasury in a notice published on March 27, 2003 (68 FR 15039).

(Approved by the Office of Management & Budget under control number 1505-0190)

5. Section 50.9 is added to Subpart A to read as follows:

§ 50.9 Procedure for requesting general interpretations of statute.

Persons actually or potentially affected by the Act or regulations in this Part may request an interpretation of the Act or regulations by writing to the Terrorism Risk Insurance Program Office, Suite 2110, Department of the Treasury, 1425 New York Ave NW, Washington, D.C. 20220, giving a detailed explanation of the facts and circumstances

and the reason why an interpretation is needed. A requester should segregate and mark any confidential business or trade secret information clearly. Treasury in its discretion will provide written responses to requests for interpretation. Treasury reserves the right to decline to provide a response in any case. Except in the case of any confidential business or trade secret information, Treasury will make written requests for interpretations and responses publicly available at the Treasury Department Library, on the Treasury website, or through other means as soon as practicable after the response has been provided. Treasury will handle any subsequent request for information that had

been designated by a requester as confidential business or trade secret information in accordance with Treasury's Freedom of Information Act regulations at 31 CFR Part 1.

Dated: July 7, 2003

Wayne A. Abernathy

Assistant Secretary of the Treasury